State of Illinois
Pension Laws Commission

Principles of Pension Policy

I. Preamble

The Pension Laws Commission recommends the following statement of principles as the basis for evaluating proposed public pension legislation. Problems can be avoided or minimized if a sound set of principles is used as a guideline in developing the various public pension funds and plans.

II. Substantive Principles

A. Purpose of Illinois Public Pension Plans

1. Illinois public pension plans should play their appropriate role in providing financial security to public employees in retirement, by providing, in combination with federal Social Security coverage where a system or fund participates in Social Security, personal savings and other relevant financial sources, retirement income that is adequate and affordable.

2. Illinois public pension plans exist to augment the public employer's personnel and compensation system by assisting in the recruitment of new qualified public employees, the retention of existing qualified public employees, and the systematic out-transitioning of existing public employees at the normally expected conclusion of their working careers.

3. As Illinois public employee workforce trends develop, public pension plans should be sufficiently flexible to make necessary adaptations consistent with the Illinois Constitution's prohibition against diminishment of benefits.

B. Structure of Illinois Public Pension Coverage

1. <u>Creation of New Pension Plans</u>
   Illinois public employers, on their own initiative, without legislative authorization, should not be permitted to establish or maintain new public pension plans.

2. <u>Mandatory Public Pension Plan Membership</u>
   To the extent possible, membership in a public pension plan should be mandatory for all personnel employed on a permanent basis.

3. <u>Consolidation of Public Pension Plans by an Illinois public employer</u>
   The voluntary consolidation of smaller public pension plans is desirable, with large public employee pension plans replacing a large number of small local plans.

C. Pension Benefit Coverage

1. <u>Defined Benefit Plans and Defined Contribution Plans</u>
   a. Defined benefit plans are the primary retirement coverage for Illinois public employees.

b. Defined contribution plans are particularly appropriate where interstate portability or private sector-public sector portability is a primary consideration of the public employee group, where the public employee group lacks civil service or analogous employment protections, or where the defined contribution plan is offered as an optional alternate plan.

2. Equal Treatment within Pension Plans
   There should be equal pension treatment of public employees within each pension plan in terms of the relationship between benefits and contributions.

3. Appropriate Normal Retirement Ages
   The normal retirement age should be set in a reasonable relationship to the employability limits of the average public employee and should differentiate between regular public employees and protective and public safety employees. In general, the appropriate normal retirement age for regular public employees is age 60 and for police officers and firefighters should be age 50 to 55.

4. Vesting Requirements
   All retirement systems should have vesting periods of 5 to 10 years for retirement annuities, 1 –to 2 years for disability and survivors' benefits.

5. Alternative Formula Coverage
   Public employee pension plans should add new groups of employees to the alternative formulas only if an Attorney General's opinion has been requested and received indicating that the group has full police powers and is exempt from Social Security (State systems only).

6. Appropriate Early Retirement Reductions
   Public employee pension plans should not subsidize early retirement benefits and, except for appropriately designed early retirement incentive programs, retirement benefits should be actuarially reduced for retirement before any applicable normal retirement age.

7. Adequacy of Benefits at Retirement
   a. Benefit adequacy requires that retirement benefits respond to changes in the economy.
   b. The retirement benefit should be adequate at the time of retirement and should be formulated with consideration to social security coverage.
   c. The retirement benefit should be related to an individual's final average salary, determined on the basis of the highest four successive years' average salary.
   d. Except for police or firefighters, the measure of retirement benefit adequacy should be calculated on a minimum of 30 years of service, which would be a reasonable public employment career, and at the generally applicable normal retirement age.
   e. The measurement of retirement benefit adequacy for police and firefighters should be at age 50 to 55, with a minimum vesting requirement of 20 years of service.
   f. Retirement benefit adequacy must be a function of the Illinois public pension plan benefit and any Social Security benefit payable resulting from public employment.

8. Postretirement Benefit Adequacy
   a. The retirement benefit should be adequate during the period of retirement.

b. Postretirement benefit adequacy should function to replace the impact of economic inflation over time in order to maintain a retirement benefit that was adequate at the time of retirement.
c. In order to replace inflation, the post retirement adjustment system should follow a valid recognized economic indicator.

9. <u>Minimum Annuities</u>
   a. All public pension funds should provide a minimum annuity for all retirees, survivors and disability annuitants.
   b. The minimum retirement, survivor, and disability annuities should be based on the employees' years of service and may take into account the number of years in retirement.
   c. The minimum annuities should receive post retirement annual increases.

10. <u>Survivor Benefits</u>
   a. Post-retirement survivor benefits should be based on a percentage of the retiree's annuity.
   b. Pre-retirement survivor benefits should be based on a percentage of the employee's salary or earned annuity, with a reasonable vesting period for eligibility (1-2 years).

11. <u>Reciprocity</u>
   To the extent feasible, reciprocity should be established as broadly as possible for public employees.

12. <u>Purchases of Optional Service Credit</u>
   a. Purchases of public pension plan credit for periods of prior service should be permitted only if it is determined that the period to be purchased is public employment.
   b. The prior service period must have a significant connection to Illinois, and the payment from the member or from a combination of the member and the employer must equal the actuarial liability to be incurred by the pension plan for the benefit associated with the service credit purchase.
   c. Only active and inactive members (not retirees and non-members) of a public pension plan should be allowed to purchase prior service credit.
   d. The purchase of service credit should not be allowed in a public pension plan for non-compensated employment.

13. <u>Revocation of Optional Service Credit Purchases</u>
   Members of Illinois public employee pension plans should not be allowed to revoke the election to purchase optional service credit after all the required contributions have been made by the employee and the service credit has been granted by the fund.

14. <u>Service Credit Terminated by Receipt of a Refund</u>
   Only active and inactive members of a public employee pension plan should be allowed to reinstate service credit that was terminated by receipt of a refund.

15. <u>Deadline Extensions and Waivers</u>
   Deadline extensions or waivers should be permitted only if, on a case-by-case basis, it is determined that there is a sufficient equitable basis for the extension or waiver, the extension or waiver does not involve broader applicability than the pension plan

members making the request, and that the extension or waiver is unlikely to constitute an inappropriate precedent for the future.

16. <u>Benefit Increase Retroactivity</u>
Retroactivity of benefit increases for retirees and other benefit recipients should not be permitted.

17. <u>Repayment of Previously Paid Benefits and Resumptions of Active Member Status</u>
Repayments of previously paid benefits and resumptions of active member status should not be permitted.

18. <u>Duplicate Public Pension Coverage For the Same Employment</u>
Public employees should not be eligible to participate in more than one Illinois public pension plan for the same period of service with the same public employer.

19. <u>Reemployed Annuitant Earning Limitations</u>
   a. Limitations on the earnings by reemployed annuitants should apply only to the reemployement of an annuitant by an employing unit that is a participating employer in the same public pension plan from which the annuitant is receiving a pension benefit.
   b. Reemployed annuitant earning limitations should be standardized to the extent possible among the various Illinois public pension plans.

20. <u>Disability Definitions</u>
The definitions of what constitutes a disability giving rise to a disability benefit should be standardized to the extent possible, recognizing the differences in the hazards inherent in various types of employment.

21. <u>Design of Early Retirement Incentive Programs</u>
   a. Early retirement incentive programs can have a valid role in a public sector personnel system.
   b. Early retirement incentive programs should be targeted to situations when a public employer needs to reduce staffing levels beyond normal attrition or reduce payroll expenditures.
   c. Early retirement incentive programs should be financed appropriately, with the cost of the benefits provided under the early retirement incentive program borne by the participating members and the public employer that gains any compensation savings from a staffing level reduction, without any subsidy from the affected public pension plan.
   d. Employee and employer contributions to amortize the cost of an early retirement incentive program should be separate from normal retirement contributions and should be completed during the expected period of compensation savings.
   e. An employer that has provided an early retirement incentive program for its employees may not provide another early retirement incentive program until the liability arising from the earlier program has been fully paid.

22. <u>Supplemental Pension Plans</u>
   a. Public employees should be encouraged to engage in personal savings for retirement.

b. The State should assist this process by making personal retirement savings opportunities available to public employees.
c. Public employers should have an opportunity to elect to provide financial support to established supplemental pension arrangements for their employees.

23. No Intended Ultimate Benefit Diminutions
a. In recommending benefit plan modifications, the imposition of reductions in overall benefit coverage for existing pension plan members should not be recommended.
b. The imposition of a reduction in overall benefit coverage may be imposed for new pension plan members in order to achieve sound pension policy goals.
c. A reduction in some aspect or aspects of benefit coverage may be recommended in combination with a proposed benefit increase or benefit increases in implementing sound pension policy goals.

D. Pension Plan Funding

1. Equal Pension Financing Burden for Generations of Taxpayers
A financing method should be utilized that will distribute total pension cost fairly among the current and future generations of taxpayers and that will discourage unreasonable benefit demands.

2. Actuarial Funding of Pension Benefits
a. Retirement benefits in Illinois defined benefit plans should be funded on an actuarial basis.
b. Currently earned pension plan service credit, as measured by the actuarially determined method utilized by the system providing the defined benefit pension plan, should be funded on a current basis.
c. The administrative expenses of the defined benefit pension plan should be funded on a current basis.
d. Existing unfunded actuarial accrued liabilities of the defined benefit pension plan should be amortized over a reasonable period of time, and that amortization period should be related to the average working career of the membership of the pension plan, but not to exceed forty years.

3. Allocation of Funding Burden Between Members and Employers
a. Retirement benefits should be financed on a shared basis between the public employee and the public employer.
b. For general public employees, the employee and employer should make contributions to meet the normal cost and administrative expenses of the defined benefit pension plan. Both the employee and employer may be required to share some financial responsibility for funding the amortization requirement for a proposed benefit increase in a defined benefit pension plan.

4. Funding of Postretirement Adjustments
a. Ad hoc postretirement adjustments should be funded separately from the regular defined benefit public pension plan financing.
b. Automatic postretirement adjustment mechanisms should be funded on an actuarial basis as part of the actuarial requirements and contribution structure of the defined benefit public pension plan.

5. Appropriate Basis for Actuarial Assumption Changes
   a. Actuarial assumption changes should only be based on the results of the gain and loss analyses in the regular actuarial valuation reports and the results of a periodic experience study.
   b. Actuarial assumption changes should stand on their own merit, and should not be changed solely to improve benefits or to lower contribution rates.

6. Appropriate Basis for Modifying Contribution Rates
   a. Member and employer contribution rates should only be modified based on the trend in total experience revealed in the regular actuarial valuation reports or in conjunction with a benefit increase.

E. Pension Plan Investments

1. Appropriate Investment of Public Pension Assets
   a. Public pension plan investment authority should be as uniform as practicable.
   b. Public pension plan investments should be made in accord with the prudent person rule.
   c. Public pension plan investment authority may be further regulated by a list of authorized investment types, which should appropriately differentiate between pension plans based on asset size and investment expertise.
   d. Written investment policies should be maintained for the investment of public pension plan assets.
   e. Public pension plans should regularly report on their investments, including performance.

2. Sole Membership Benefit Dedication of Plan Assets

   Recognizing that public pension plan assets exist to defray current and future benefit payments, public pension plan assets should be dedicated to the sole benefit of the plan membership in the investment and expenditure.

F. Compliance with Federal Pension Plan Regulation

Consistent with the principles of federalism, dual sovereignty, and comity among governmental entities, public pension plan provisions and administrative operations and activities should attempt to comply with applicable federal pension plan regulations in order to maintain the tax qualified status of public pension plans.

G. Public Pension Plan Fiduciary Responsibility

1. Strong Fiduciary Responsibility Status

   Public pension plan activities should be conducted in accord with strong fiduciary responsibility standards and regulation.

2. Remedies for Fiduciary Breach

   Failures to conduct pension plan activities in accord with the applicable fiduciary responsibility standards and regulation should be subject to appropriate fiduciary breach remedies.

III. Procedural Principles and Pension Policy

A. Adequate Pension Funding

1. Pre-Existing Funding

   No proposed increase in pension benefits for any public pension plan should be recommended by the Pension Laws Commission until there is established adequate financing to cover the pre-increase normal cost, administrative expense, and amortization contribution requirements of the defined benefit public pension plan calculated according to sound actuarial standards.

2. Funding Increase

   Proposed increases in pension benefits for any defined benefit public pension plan recommended by the Pension Laws Commission should include, in the proposal, adequate financing to meet any resulting increase in the normal cost and amortization contribution requirements of the defined benefit public pension plan that are estimated by the applicable actuary to result from adopting the proposed benefit increase.

B. Preference for General Legislation

No pension legislation of local or special limited application should be recommended by the Pension Laws Commission if the purpose and intent of the proposed legislation would be better served by legislation of general statutory application or if the proposed legislation constitutes a significant departure from previously established uniform pension policy.

C. Explicit Application of Principles of Pension Policy

1. Measurement Against Principles

   Each proposed change in retirement benefits or financing should be measured by the Pension Laws Commission against the current principles of pension policy as part of its consideration to insure that there is adherence to sound pension policy.

2. Formal Reporting of Consistency

   The Commission's determination concerning compliance with the principles of pension policy should be part of the Commission's formal report of its recommendations on proposed public pension legislation.